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Income Support for Farmers and Reform of Agricultural Subsidies

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INCOME SUPPORT FOR FARMERS
AND
REFORM OF AGRICULTURAL SUBSIDIES

Presented to

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Deputy Ministers of Agriculture

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by

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I. INTRODUCTION

Farmers in all major producing countries are suffering from the effects of large (grain) surpluses. Attempts by some countries to reduce their excess stocks by means of export subsidies exacerbate the problems for farmers (and governments) in other countries, and do nothing to solve the general oversupply problem.

While the super-abundance of grain causes economic hardship to our farmers, hundreds of millions of people in other parts of the world suffer from hunger. We are told by the World Food Council that 40,000 little children die of malnutrition each day. It is sad but true that we are no closer to solving this terrible paradox of burdensome excess and dire want than we were twenty or thirty years ago. I do not think that the problems of hunger and poverty, at home or abroad, can be solved without making gradual but nevertheless fundamental changes in our economic system. Ultimately, cooperation and sharing must replace competition and the pursuit of wealth as guidelines for human behavior. If the human race is to survive we have to do more than pay lip service to the idea that this is one world and that all human beings have the same basic rights and freedoms, including the freedom from hunger and disease. In the meantime we must increase our efforts to reduce hunger and poverty in the world through food aid, development assistance, and the promotion of peace and

international cooperation. Canada has a good record in these areas but we can and should do more, and we must urge other wealthy countries to do more as well.

From the perspective of market economics the current crisis in western agriculture results from a long process of expanding production in the face of stagnating effective demand for foodstuffs. All governments have contributed to the process of expanding agricultural production through a wide variety of measures to assist and protect farmers. The export subsidies which have caused such demoralization among agricultural exporting countries are but the latest and most blatant example of farm subsidies. They are also the most damaging to countries that rely heavily on agricultural exports, and they do great harm to international relations because they are manifestations of economic warfare.

The Government of Canada has energetically pursued initiatives to get the questions of subsidies and trade restrictions placed on the agendas of formal and informal international discussions and negotiations. Acting on behalf of the Cairns group of agricultural exporting countries, Canada has raised the question at the economic summit in Venice. Together with other countries Canada has brought pressure to bear in the OECD to urge steep reductions in subsidies and in international trade barriers, and Canada has strongly

supported motions to include agriculture in the Uruguay round of GATT negotiations.

A communique of the OECD meeting in May indicated that the member countries had agreed to five principles (which had been strongly advocated by Canada):

1. Agricultural policies should encourage responsiveness to market prices.
2. Agricultural subsidies should support farmers rather than farming; policies which include production incentives should be avoided.
3. Countries should freeze and try to reduce subsidy measures that distort world market prices.
4. Countries should not introduce any new restrictions on agricultural imports.
5. All members of the OECD should implement these basic principles collectively.

Canada's international trade Minister is said to have hailed the deal as "a major breakthrough". She told a news conference after the meeting that: "We have really turned the corner at this meeting towards a more rational and sane agricultural policy", and that "...We have sown the seeds for an early harvest of agricultural reform."

To state it more clearly and less diplomatically, the agreement on these principles means that farmers in the OECD countries must be induced to produce

less by withdrawing subsidies and thereby lowering their returns. That is what responsiveness to market prices is all about.

It must be admitted that the principles are consistent with the philosophy of a market economy. Price responsiveness is the pivotal element in market economics. The price system serves to allocate resources and to determine the returns to the factors of production. Market prices tell farmers whether they produce too little, just enough, or too much of a certain product and whether they should shift from one product to another. Government programs of price supports, stabilization and deficiency payments distort the signals from the market, and therefore interfere with the allocation of resources in accordance with market demand. Within the context of a market economy the principles advocated by Canada and adopted by the OECD are therefore eminently sensible. It must be noted, however, that these principles are the opposite of what Canadian agricultural policy has been and still is.

The adoption of the OECD principles requires, therefore, that we examine the role of subsidies and agricultural support programs in Canadian agricultural policies, that we examine the effects of support programs on farm incomes and the structure of agriculture, and that we, perhaps, reassess the objectives of

agricultural policies and alter our support programs to meet the new objectives.

II. THE EFFECTS OF DIFFERENT SUPPORT PROGRAMS

Government programs in support of agriculture may conveniently be divided into two major categories: support on the production and input side, and support on the marketing and revenue side.

1. Farm Input Supports

Government support programs on the input side range from basic research in biotechnology to assistance in the digging of a well. The benefits of research usually become available to farmers in a slow and gradual way; the typical result is an increase in production which, other things being equal, will cause a decline in prices. Thus the benefits are passed on to the consumers. Other government programs to reduce the costs of farming initially increase the profitability and hence boost the farmers' incomes. However, the cost reduction and improved profitability induce farmers to bid up the price of land and to expand production; the increases in supply cause prices to decline until they are once more equal to the costs of production. Thus the benefits of governmental assistance programs are partly capitalized into land values and partly passed on

to the consumers. Farmers benefit as land owners rather than as farm operators (except for the short run); citizens benefit as consumers but lose as tax payers. Where, as is the case with grains, the products are marketed abroad, the effect of cost reducing policies may be that Canadian producers may acquire a larger share of the international market than they could otherwise have done, and that the price of agricultural land may be higher than it otherwise would have been. Apart from that, the cost reductions attributable to government assistance tend to be passed on to Canadian and foreign buyers instead of being retained by agricultural producers. For these reasons, farmers often describe such government programs as "cheap food" policy. I would like to emphasize that "cheap food" is not a policy objective, but is the result of the competitive conditions in agriculture.

The converse of the proposition that the benefits of cost reducing government support programs are not retained by farm operators but are passed on to consumers and to landowners is that withdrawal of the support programs would reduce the profitability of farming only in the short run. The higher cost of inputs affected by the withdrawal of government support would cause a decrease in supplies of agricultural products, followed by an increase in prices until prices and average costs would be in equilibrium again. One

could expect land prices to decline and farm incomes to return to their previous level. Consumers could expect increases in food prices, but the consumer losses would be more than offset by savings in government expenditures which in turn could lead to reduced taxes or reduced deficits.

2. Prices and Income Supports

Farmers tend to benefit more immediately from revenue increasing programs than from most cost reducing programs. Revenue increasing programs include price supports and deficiency payments.

While the impact of different programs on farmers, consumers and tax payers may vary slightly from case to case, the effects are generally the same as with cost reducing programs, eg. increased output, pressure on market prices, greater share of world markets for some products, higher land values. If the price supports are paid from general revenue, citizens benefit as consumers and lose as tax payers, the tax payers' losses exceeding the consumers' gains. If the price support is achieved by administering prices (two price wheat), the consumers bear the cost of the built-in tax.

3. Supply Management Schemes

Price stabilization in eggs, dairy and poultry products has been achieved by abolishing the free

markets. Administrative authorities have been established by federal and provincial legislation to decide how much of these products may be produced, who may produce them, and what their prices shall be. The fixed prices and assured markets provide farmers with stable returns for their labour and investment. The profits are soon capitalized into market values for production quotas which provide producers with additional income in the form of capital gains. Less comprehensive supply management or orderly marketing schemes operate on the provincial level to control the production and marketing of a host of other farm products. The effectiveness of the provincial schemes depends on the degree of market control they are able to exercise, which is largely determined by actual or potential imports. The cost of supply management schemes is borne by the consumers.

4. Distributional Effects of Support Programs

Generally speaking, agricultural support programs are made available to all farmers on the basis of volume of inputs used and products marketed, eg. tax rebate or exemption per litre of fuel used, deficiency payment per kilogram of pork marketed, WGSA payment per dollar of grain marketed, WGTA subsidy per tonne of grain shipped. In effect, Canadian agricultural support programs are tied to production and to scale of operation. The result is that the largest farmers are

the greatest beneficiaries of government support programs and that the programs are of only marginal benefit to the small scale operators. Hence the 30 percent of farms which account for 70 percent of all sales of farm products are likely to also receive 70 percent of the benefits of agricultural support programs. Those who have most get most and those who have little get little. Since need is not taken into account, there is a serious problem of equity in the distribution of government assistance among farmers. There is a further question of equity of transferring money from tax payers to farmers: are the people who pay the bulk of the taxes better off than the farmers who receive the bulk of the subsidies?

III. WHERE DO WE GO FROM HERE?

Federal and provincial governments support agriculture in a massive way. The cost of agricultural support programs in the current year is well in excess of $5 billion. Most of that support flows to the 30 percent of the farmers who account for 70 percent or more of Canadian agricultural output. The ability to compete in world markets or against potential imports has always ranked high among the justifications for government support for farming. Other countries have followed similar policies and have used similar justifications for them. The policies were bound to lead to

surplus production and to successive escalations in subsidies so that finally their predatory intent could no longer be hidden and their ultimate futility became clear to all. By pleading for an end to the subsidy war, Canada and the Cairns group countries have in effect "cried uncle". Although it may take a few years for the message to sink in, the OECD agreement amounts to a recognition that there are no more worlds to be conquered by or for our grain producers.

From Confederation to the present, improving the productivity and competitiveness of the Canadian farmer with the aim to expand markets abroad and to maintain markets at home has been the cornerstone of Canadian agricultural policies. What was hailed as a "breakthrough in agricultural reform" by our Minister for External Trade knocks that cornerstone out of a hundred years of agricultural policies.

To support the grand objective of capturing foreign markets, programs are designed to provide incentives for inputs and to tie income support to production and marketing rather than to need. Now the OECD agreement says that government support for farming must be replaced with support for farmers. Our Minister of Finance has said that "farmers will not be left high and dry". But if farmers are not to be supported on the basis of production, what other basis shall or should be used? What shall be or should be the new objectives of

agricultural policy?

1. Competitiveness

It is probably correct to assume that the immediate aim of the OECD countries is to halt the drain on their treasuries caused by farm subsidies, that they want to wean farmers away from their reliance on governments, but that they have no intention of radically changing their present systems, as one might infer from the OECD communique. It would be most unusual if the governments involved had a clear idea of where they want to go. The following observations seem to be in order:

-- If a formal agreement is concluded, governments will lose their principal scapegoats if they can no longer blame foreign countries for the troubles farmers are in; farm leaders lose their principal scapegoat if they cannot blame the government for the troubles of farmers.

-- As scapegoats lose credibility more and more farmers may come to the realization that the real competition is with ones neighbours and not with farmers in the USA or in Europe. Natural barriers (transportation and handling costs) and manmade barriers (tariffs and import restrictions) cushion the competition between grain farmers in Western Canada and in Northern France. There is no cushion softening the competition between

neighbouring farmers in either country.

-- The opinion makers' loss of scapegoats and the farmers' improved understanding of the nature of competition may force everyone to face the problems and issues with greater realism and honesty. It is much easier to sell the concept of competition in the abstract than in the concrete. In the abstract competition brings efficiency in production and abundance in consumption. In the concrete competition brings farm foreclosures, uprooted families and untold sufferings. It has also always been easier to sell the idea of competitiveness with foreigners than with ones neighbours. Farm bankruptcies in Kansas and Northern France do not upset the editors of Canadian newspapers, Canadian farmers or Canadian politicians, but they all become indignant when the rate of farm foreclosures rises in Ontario or the Prairies. Yet the cause of the bankruptcies is the same in all cases: competition or economic warfare among neighbours.

-- At any rate, it will be difficult to maintain that improving the competitiveness of the Canadian farmer is the major goal of agricultural policy while we are pursuing international agreements that would outlaw government supported competitiveness.

2. Justification of Policies

Although improving competitiveness is no

longer an appropriate goal of Canadian agricultural policies, the policies must nevertheless recognize that Canadian farmers will be operating under competitive conditions in the foreseeable future. The task at hand is to translate the expression "...support must be for farmers rather than for farming..." into explicit policy objectives and to develop strategies to realize them. In carrying out that task many difficult and controversial issues are bound to emerge.

A general policy to support farmers is likely to be more controversial than our present policies in support of farming.

The policy goal of improving the competitiveness of farmers has often been used as the reason for not targeting help to those farmers who were most in need, eg. small low income farm families. If the official policy becomes support for farmers, different criteria will have to be applied and the question of need will inevitably come to the surface.

The inequities of support programs tied to production and marketing have always been justified on the need to remain competitive with agriculture in other countries. If that justification can no longer be used the inequities can no longer be defended and a more equitable basis of support must be found. The largest and most prosperous farmers who now receive most of the money the government doles out in farm supports are

likely to put up strong resistance to a fundamental change in policy.

Ironically, some of our present programs in support of farmers are or have been sold to the tax paying public as programs supporting the farming industry. Such programs may come under renewed scrutiny when new and different objectives for agriculture are made explicit.

Support programs for farmers rather than farming must ultimately meet the test of equivalency with support for other groups or individuals in society. It will be much more difficult to plead special status or to justify special treatment for farmers when international competitiveness is no longer the justification.

The formulation of new objectives for Canadian agriculture and the development of new policies to realize them present us with exciting challenges. The objectives we set and the policies we develop will reflect the values we hold dear as a society. We Canadians are proud of our country and of our individual rights and liberties. While we celebrate our blessings and toast our rights and freedoms, we may at times forget the roots from which the concept of freedom springs. If we forget the roots, we run the risk of severing ourselves from them and our cherished freedoms will wither and die. At bottom, human rights and

freedoms are based on the respect for the dignity of the human person.

The surplus in agricultural production that the governments of the OECD countries are now attempting to deal with has the same causes as the surpluses in steel, automobiles, computer chips, textiles, farm tractors, or anything else one cares to think of. There are countless people in the world whose lives would be enriched if they had more steel, automobiles, computer chips, textiles, farm tractors, as well as food. The trouble is they do not have the money to buy, while those with money have more than enough of these things already.

For years, governments protected profits and jobs in the manufacture of steel, ships, textiles and a host of other industries with huge subsidies in the hope that some day the market would turn around, or the government of a competing country might give up, and the surpluses would disappear. When they finally reduced or eliminated the subsidies, companies went bankrupt or merged with others and workers were layed off. The OECD countries count 31 million workers who have been forced into idleness. Now those countries have decided that the time has come to cut subsidies for agriculture. How many farmers will join the 31 million workers in forced idleness will largely depend on the size of the cuts in government subsidies and the speed with which they will

be made.

When we begin to set new objectives for agricultural policy in Canada and to develop strategies to realize those objectives we must put the dignity of the human person at the centre of our deliberations. The well being and the economic security of farm families must be high among the objectives of agricultural policy. This must go hand in hand with economic policies that start from the premise that every person has a right to meaningful employment and every family has a right to live and work in dignity. We must be willing to make whatever changes are required in economic regulations and international relations in order to achieve those goals. That will require enormous political will, which we can summon up if we keep reminding ourselves of the ultimate objective: the realization of the dignity of every human person.